VZCZCXRO6722
RR RUEHDE
DE RUEHCV #0394/01 0451526
ZNY CCCCC ZZH
R 141526Z FEB 06
FM AMEMBASSY CARACAS
TO RUEHC/SECSTATE WASHDC 3178
INFO RUEHHH/OPEC COLLECTIVE
RUEHBO/AMEMBASSY BOGOTA 5992
RUEHBR/AMEMBASSY BRASILIA 5175
RUEHLP/AMEMBASSY LA PAZ 1653
RUEHPE/AMEMBASSY LIMA 9858
RUEHSP/AMEMBASSY PORT OF SPAIN 3115
RUEHQT/AMEMBASSY QUITO 1725
RHEBAAA/DEPT OF ENERGY
RUCPDOC/DEPT OF COMMERCE
RUEATRS/DEPT OF TREASURY
RHEHNSC/NSC WASHDC

C O N F I D E N T I A L SECTION 01 OF 02 CARACAS 000394

SIPDIS

SIPDIS

ENERGY FOR CDAY, DPUMPHREY, AND ALOCKWOOD

E.O. 12958: DECL: 02/25/2016
TAGS: EPET ENRG EINV VE
SUBJECT: CURRENT STATUS OF OSA MIGRATIONS: NOT VERY PRETTY

REF: A. 2005 CARACAS 03758
¶B. CARACAS 00065
¶C. CARACAS 00190

Classified By: Economic Counselor Andrew N. Bowen for Reason 1.4 (D)

¶1. (C) SUMMARY: Progress on negotiations on the migration from operating service agreement (OSA) to joint venture companies continues to be bogged down over basic issues such as block reserves certification and value assessment, the formula for valuing crude production, and royalty calculations and payments. As the April 1 deadline gradually grows more unrealistic, the Ministry of Energy and Petroleum (MEP) has told the companies that each of them needs to sign a memorandum of understanding (MOU) by the end of March in which they commit to sign the joint venture agreement under current terms. In addition, MEP will submit joint venture guidelines to the National Assembly by the end of this month. MEP expects three or four companies to drop out of the OSA negotiations. END SUMMARY

CURRENT STATE OF OSA NEGOTIATIONS

¶2. (C) According to minutes of the January 2006 monthly exploration luncheon held by oil companies operating in Venezuela (strictly protect), progress on negotiations on the migration of OSAs to joint ventures in which PDVSA holds a controlling interest have bogged down. Companies continue to complain that the executive transition committees that are supposed to manage the OSA fields during the transition do not seem to have clear roles and perform different functions with different operators (See Reftel A). As a result, the operators have stated they will continue to work under the OSAs until the joint ventures enter into force.

¶3. (C) The oil companies are currently negotiating a sixth version of the joint venture agreement. Block reserve certification and value assessment are still key sticking points (See Reftel A). The Venezuelan Petroleum Corporation (CVP), a PDVSA subsidiary which acts as a liaison with foreign oil companies, will nominate a third party to handle the certification of reserves. Since the reserves are not certified and pre and post migration business plans and production profiles are unavailable, it is impossible to establish the value of each of the OSA fields. In addition, the OSA companies claim the 2001 Hydrocarbons Law must be

amended to allow the new joint ventures to commercialize oil to PDVSA and enjoy a sales tax exemption. The companies are also unhappy about MEP's equation for valuing crude oil. The proposed equation contains a variable that MEP can define at its convenience.

¶4. (C) Royalty calculations also appear to be a problem. It appears the MEP wants the calculations to be based on the destination of the crude oil. In addition, the MEP and PDVSA have been hinting recently that they are considering accepting royalty payments in kind (Reftel B). Although the option is very attractive to some companies, it would require a new royalty definition. It is not clear if there will be additional options for royalty payments. Companies also have questions regarding what currency will be used for the payment of profits to joint venture partners. If it is USD, then foreign currency regulations will have to be amended.

¶5. (C) The CVP has also told companies that some of the new joint ventures would receive additional acreage in order to make them commercially viable for all of the partners (Reftel C). It now appears that the new acreage will be reduced to only contain the exploitation area.

¶6. (C) According to the minutes, the MEP expects three or four companies to drop out of the OSA negotiations. This may explain why CVP President Del Pino told us that he expected to see 10 or 12 joint ventures rather than 16 as he originally told an industry association (Reftel C).

HOW ABOUT A NICE MOU?

¶7. (C) The MEP and PDVSA have repeatedly and publicly stated the joint venture agreements must be presented to the National Assembly for approval on April 1. Given the vast number of issues that must be negotiated, energy attorneys and oil company executives have been highly skeptical about meeting the deadline. It now appears that the MEP has realized that the April 1 deadline is unattainable. MEP Deputy Minister Bernard Mommer notified the companies that they needed to sign a new MOU by the end of March whereby the companies commit to sign joint venture agreements under current terms.

¶8. (C) COMMENT: It is not clear what the luncheon minutes mean by "current terms". An energy company executive told Petroleum Attach (Petatt) that President Chavez canceled a speech that he was to give the week of February 6 on the conversion of the OSAs to joint ventures due to the failure to resolve operators' objections to the MOU. According to the executive, the speech was to be held at Petrobras' Concepcion oil field in Zulia and the highlight of the speech was to be the signature of the MOU by Petrobras. Petrobras refused to sign the MOU because it contained numerous terms on the conversion that Petrobras found objectionable. The MOU contained a significant number of terms that were supposedly still being negotiated. As a result, the speech was called off at the last minute. Two oil company executives told Petatt they were told of the cancellation minutes before they left their office to travel to Zulia. END COMMENT

¶9. (C) Deputy Minister Mommer also plans to present guidelines for the joint venture agreements to the National Assembly by the end of the month. The guidelines will contain information on the parties' working interests, the relevant exploitation areas, and specific terms for second and third round OSAs. (NOTE: The OSAs were awarded in three rounds. END NOTE) According to the minutes, the guidelines will be presented to the National Assembly if the operators agree. If not, negotiations will continue.

EXPLORATION AND PRODUCTION

¶10. (C) The minutes stated none of the attendees carried out development drilling and workover activity as a result of contract uncertainties arising from the transition negotiations. Average production in the OSA fields declined by 190 barrels to 474,296 barrels per day in January. Extra heavy crude oil production in the four strategic associations fell 4.18 percent to 595,024 barrels per day in December. The strategic associations produced on average 561,213 barrels of syncrude per day in December.
BROWNFIELD